social spending and the next budget

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SOCIAL SPENDING AND THE NEXT BUDGET

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National Council of Welfare
Brooke Claxton Building
Ottawa K1A 0K9
(613) 957-2961

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SOCIAL SPENDING AND THE NEXT BUDGET

The federal government is under pressure from business groups to cut social spending in order to fight the deficit. They exclaim: 'The deficit is out of hand. Social spending must be reined in now or the country will not be able to afford to pay any benefits in future. Rich bankers shouldn't get family allowances'.

There is nothing new in these arguments. We have heard them many times before. We will hear them again.

But they are just not true.

The Minister of Finance has made substantial progress in bringing down the deficit, though the high interest rate policy of the Bank of Canada is making his job harder. Social spending has not increased; to the contrary, Ottawa is spending the same now on social programs as it was five years ago. Rich bankers are few and far between, they don't get family allowances - their wives do - and most of the baby bonus budget goes to low and middle-income parents.

Is the Deficit Out of Control?

A lot of attention has focussed on the cost of financing the public debt. There is no question that this portion of federal expenditures has grown significantly: it now consumes one-quarter of government spending. Table 1 shows that public debt charges grew from $27.5 billion in 1984-85 to an estimated $33.0 billion in 1989-90. (These figures, derived from the 1988 federal budget, have been converted to constant 1989 dollars in order to discern real trends.) Recent hikes in interest rates are driving these costs upward.

However, the annual deficit - the difference between what the government spends on programs, services and debt financing charges and what it collects through taxes - is another story altogether. The deficit stood at $47 billion in 1984/85 (in constant 1989 dollars) and has been cut to the point where it will amount to about $29 billion this fiscal year - less than two-thirds of what it was in the mid-'eighties. Figure A illustrates the steep downward trend in the federal deficit. Figure B paints a similar picture when we express the deficit as a percentage of Canada's Gross Domestic Product (GDP), falling from 8.6 percent in 1984/85 to 4.6 percent in 1989/90.

Is Social Spending Out of Control?

Contrary to popular perception, the government has held the line on social spending. This record is all the more impressive in view of the ever-increasing pressure exerted by an aging population on health and social programs. In 1984/85, total federal expenditures on statutory social programs (including health care) amounted to $44.3 billion or 33.2 percent of total government spending. The forecast for 1989/90 is $ 44.2 billion or 32.8 percent of overall spending. Table 1 gives the figures for 1984/85 though 1989/90 and Figure C shows that social spending has remained virtually flat over the five-year period.

The economy has been growing faster than social spending, as evidenced by Figure D. As a result, social spending as a percentage of the Gross Domestic Product (GDP) declined from 8.1 percent in 1984/85 to 7.1 percent in 1989/90.

Figure E illustrates the trend in social spending from 1984/85 to 1989/90 for the five major statutory programs, ranked from most to least expensive - old age pensions (OAP), unemployment insurance (UI), Established Programs Financing (EPF), the Canada Assistance Plan (CAP) and family allowances (FA). The only program which shows a steady real increase is old age pensions; spending on the other four programs either remained flat or declined somewhat.

Let's look at each program in turn. Figures F through J plot the trends from 1984/85 through 1989/90.

Old age pensions comprise three programs - Old Age Security, the basic pension which goes to all 2.9 million Canadians aged 65 and older; the Guaranteed Income Supplement, paid to 1.4 million low-income elderly persons; and the Spouse's Allowance, which assists 146,000 low-income persons aged 60 to 65 (but excludes low-income single individuals in the same age group who never married or are separated or divorced as well as couples in which both spouses are aged 60 to 64). Old Age Security payments will total an estimated $11.9 billion in 1989/90; the Guaranteed Income Supplement, $4.1 billion; and the Spouse's Allowance, $548 million.

Figure F shows consistent real growth in old age pension payouts, which rise from $13.9 billion in 1984/85 to an estimated $16.5 billion in 1989/90 - a substantial 18.5 percent real increase over five years. There are three reasons for the upward trend in spending on income security benefits for the elderly : 1) the aging of Canada's population; the total number of recipients of the three federal programs grew from 3.9 million in 1984/85 to 4.5 million in 1989/90; 2) in September 1985, the Spouse's Allowance was extended to 46,000 widows and widowers who previously were excluded; 3) protest from seniors' organizations

which forced the government to back down on its 1985 budget proposal to partially index Old Age Security benefits; all three programs remain fully indexed to the cost of living.

The second most costly social program is **unemployment insurance**. Figure G indicates a significant decline in unemployment insurance outlays, which went from $12.3 billion in 1984/85 to an estimated $10.6 billion in 1989/90. Steadily declining unemployment rates -the national rate fell from 11.2 percent in 1984 to 7.8 percent in 1988 - have translated into smaller numbers of unemployment insurance beneficiaries and payments. The number of UI recipients fell from 3,221,890 in 1984 to 3,079,940 in 1987, the most recent year for which data are available.

The federal government devotes a large chunk of its social spending to help finance programs and services delivered by the provinces. Under the **Established Programs Financing** (EPF) Act, Ottawa transfers money to the provinces to pay part of the cost of insured health services, extended health care and postsecondary education. Figure H shows that federal transfers under EPF declined somewhat from $10.5 billion in 1984/85 to $9.8 billion in 1989/90. The Minister of Finance managed to restrain federal spending in this area by changing the indexation formula; federal payments are now indexed by the increase in the Gross National Product less two percentage points rather than by the full increase in the GNP.

The federal government also funds half the cost of provincial social assistance (welfare) and approved social services under the **Canada Assistance Plan** (CAP). Figure I demonstrates that CAP spending has remained quite level (around $4.6 billion) since 1984/85. Welfare caseloads - which skyrocketed as a result of the recession of 1981 - have remained high despite the decline in the jobless rate in recent years.

The smallest social program is, ironically, the one that seems to be the favorite target of attack by the cut-social-spending crowd - **family allowances**. Expenditures on family allowances fell from $2.9 billion in 1984/85 to a projected $2.6 billion in 1989/90 (see Figure J). Two factors explain this decline. First, the number of children under 18 for whom family allowances are paid declined a bit, from 6,594,381 in 1984/85 to 6,535,100 in 1989/90. The more important reason was the government's decision to partially index family allowance rates starting in 1986; benefits now go up each January only by the amount of inflation over three percent a year, not by the full increase in the cost of living.

Taxes Have Gone Up

As a result of its restraint policy, the government has kept its total program spending in check. Indeed, Table 1 shows that program spending decreased from $106.1 billion in 1984/85 to an estimated $101.9 billion in 1989/90. However escalating public debt charges offset the reduction in program spending, so that overall federal spending - on programs and debt financing - rose from $133.6 billion in 1984/85 to an estimated $134.9 billion in 1989/90. Yet the deficit was slashed by 39 percent during this period. How did this happen?

The answer is tax increases. The government has collected billions more in tax revenue since 1985, thereby chipping away at the deficit. Figure K illustrates the narrowing gap between government expenditures and revenues.

Total federal revenues rose from $86.7 billion in 1984/85 to an estimated $106.3 billion in 1989/90 - a hefty 22.6 percent real increase over five years. By contrast, projected overall spending is only 1.0 percent higher in 1989/90 ($134.9 billion) than in 1984/85 ($133.6 billion).

Previous National Council of Welfare reports have examined in detail the various and numerous tax changes made since 1985. In brief, the main reasons for tax hikes and rising revenues are:

* the federal tax reduction (for lower and middle-income taxpayers) was eliminated

* two surtaxes were imposed (one, for all taxpayers, is still in effect; another, for upper-income taxpayers, lasted only eighteen months)

* the personal income tax system was partially indexed (tax brackets, exemptions and credits are indexed only by the amount of inflation over three percent a year)

* federal sales and excise taxes and duties have been increased repeatedly

Table 1 lists the various sources of federal revenue. The personal income tax system is far and away the largest generator of revenue ($47.6 billion or 44.8 percent of the $106.3 billion total this fiscal year) followed by sales and excise taxes ($26.8 billion or 25.2 percent), corporate income tax ($13.5 billion or 12.7 percent), unemployment insurance premiums ($10.2 billion or 9.6 percent) and other sources ($8.2 billion or 7.7 percent).

Figure L plots the increase in federal revenues. In percentage terms, federal sales and excise taxes increased most - they will bring in 55.5 percent more revenue in 1989/90 than in 1984/85.

Revenues from personal income tax increased by 33.0 percent, while the tax take from corporations rose by 17.7 percent over the same period.

Beneath the Bottom Line: Massive Savings from Partial Indexation

The Minister of Finance's track record in fighting the deficit is even better than the figures from his 1988 budget indicate. By partially indexing child benefits, the personal income tax system and federal transfers to the provinces for health and postsecondary education, he has collected billions more in income tax and spent billions less on social programs. The deficit would be much worse if the government had not brought in these measures.

Table 2 provides estimates of the amount of money cut from family allowances and federal transfers to the provinces under EPF and the extra income taxes collected as a result of the changes made in the indexing formulas for these taxes and transfers. The figures are staggering.

Simply by limiting the indexation of family allowances to the amount of inflation over three percent a year, the federal government will save an estimated $1.7 billion from 1986 through 1991. By deducting two percentage points from the GNP escalator for transfers to the provinces under EPF, it will save in the order of $8.2 billion over the same period. By partially indexing the personal income tax system, it will collect about $17.7 billion more in federal income tax. All in all, over the six-year period the federal treasury will be about $27 billion better off - almost the size of the current deficit.

The Anti-Deficit Medicine Has Not Been Fairly Administered

Although many, if not most, Canadians would agree that the government had to do something about the deficit, few would likely consent to a program of restraint that hit working poor and middle-income families and individuals harder than those with above-average incomes. But that is exactly what the finance minister's tax increases and social spending cuts have done. Consider the following:

a. the working poor have been hardest hit by tax increases

The removal of the federal tax reduction and the decision to partially index the personal income tax system hurt lower-income taxpayers most. Table 3 shows the average federal and provincial income taxes paid by two-earner couples with two children. The working poor family earns $24,000 in 1989, which is just under the estimated poverty line for a four-person family living in

city of 500,000 or more ($24,484). The middle-income couple's earnings total $49,000 or double the poverty line; the estimated average income for a family with two children in 1989 is $50,400. The upper-income family earns $122,000 or five times the low-income line. (We have deducted the amount of the refundable tax credit from the taxes of the low and middle-income families in order to show their actual tax bill. All figures are in constant 1989 dollars).

The income tax burden for the lower-income family rises from $1,280 in 1984 to $1,844 in 1988 and an estimated $2,050 in 1991 - an onerous tax hike of 60.2 percent from 1984 to 1991. The middle-income couple's income taxes go up by 17.4 percent over the same period. The well-off family's income taxes actually decline by 6.4 percent because it benefits from enriched tax breaks (the tax deductions for RRSP contributions and child care expenses) which the Minister of Finance introduced in the midst of his policy of financial restraint.

The overall tax burden has gone up even more because federal sales and excise taxes have risen as well as income taxes. For a two-earner couple with two children and modest earnings ($26,000 in 1988, expressed in 1988 dollars), combined federal and provincial income taxes and federal sales and excise taxes went from $3,210 in 1984 to $4,453 in 1988 - a 38.7 percent jump in just four years. The total tax bill for a family earning in the middle-income range ($42,000) rose from $7,574 in 1984 to $9,139 in 1988 - a 20.7 percent real increase. While upper-income families earning at the $100,000 level pay more taxes ($34,796 in 1984 and $38,694 in 1988), their tax burden increased by only 11.2 percent.

b. tax reform is deceptive

There is less than meets the eye in the government's tax reforms which took effect in the 1988 taxation year. While most taxpayers enjoyed an income tax reduction in 1988, they are still paying more taxes than they did only a few years earlier. Since the new income tax system, like the old, is only partially indexed, inflation will impose an automatic tax increase from 1989 on. Taxes will march ever upward and more and more working poor Canadians will have to pay income tax.

The government's tax reforms will not create a fairer tax system: What well-off taxpayers lost in the conversion of exemptions and most deductions to non-refundable credits - the value of the former increases with taxable income, whereas credits are worth more proportionately to lower-income taxfilers - they more than made up for thanks to the government's decision to lower the top marginal tax rate from 34 percent to 29 percent.

The government intends to impose a comprehensive new national sales tax that will cover as broad a range of goods and services as possible, probably exempting only groceries, prescription drugs, medical services and rent. However, the details of the new tax - e.g., the rate of taxation, which provinces will join in with the federal government, the amount and design of tax relief for low-income consumers - are yet to be announced. The new sales tax will take a couple of years to bring into being.

Sales taxes are regressive, which means that their relative burden increases as incomes decrease, and vice versa. The finance minister has promised to boost the refundable sales tax credit in order to shield low-income consumers from the impact of the new sales tax. However, even if poor people are adequately protected, modest-income families and individuals above the income cut-off for the refundable sales tax credit will be hardest hit by the new tax. One thing is almost certain: for most Canadians the overall tax burden from income and sales taxes will be heavier after tax reform and will continue to grow with each passing year.

c. middle-income families will lose most in child benefits

Federal child benefits have undergone a succession of changes:

* family allowances, the refundable and non-refundable child tax credits and the non-refundable equivalent-to-married credit (for single parents) were partially indexed

* the government substantially boosted the refundable child tax credit, from $384 per child in 1985 to $559 in 1988 ($659 for each child under age 7)

* the child care expense deduction was not changed to a non-refundable credit, contrary to the philosophy of the government's tax reform; in fact, the maximum deduction for children under 7 was doubled from $2,000 to $4,000

These changes have worked at cross purposes. The increase in the refundable child tax credit, which goes to low and middle-income families, is a welcome improvement. Yet by partially indexing the family allowance and the refundable and non-refundable children's credits, the Minister of Finance imposed a silent, automatic and effective annual cut in child benefits for families at all income levels. By doubling the child care expense deduction, a regressive tax break that is used mainly by parents with above-average incomes, he enriched a tax subsidy that will now cost the government a quarter of a billion dollars a year - most of which goes to affluent families.

Canada now has a very complex child benefits system, with the amount and type of payment varying according to family income,

the number and age of children, and whether or not the family has receipted child care expenses. Table 4 shows total federal child benefits for two-earner couples with two children (one child is under 7, the other over 7) and different levels of income. All the families receive family allowances. The welfare poor, working poor and middle-income families also get the refundable child tax credit (though the middle-income family's payment decreases significantly over time). All families except the welfare poor receive the non-refundable children's credit. The middle and upper-income families claim a child care expense deduction for the younger child.

Only the poorest family sees an improvement in its federal child benefits over the years, and a relatively modest one at that- payments for two children in 1991 will be $249 more than in 1984, for a 14.5 percent real increase. All the other families (the working poor included) suffer a loss in child benefits. The middle-income couple is hardest hit, with a $507 or 25.8 percent cut from 1984 to 1991. The family earning five times the poverty line ($122,000 in 1989) loses 5.6 percent between 1984 and 1991- little more than the working poor family, whose child benefits drop by 4.4 percent over the same period.

Will the Budget Cut Social Spending Even More?

Taxes are going up. Child benefits are being eroded by inflation. Will the upcoming budget bring further tax hikes and social spending cuts?

Probably. Here are some of the options the government could consider to pare more social spending and raise more taxes. (The reader should keep in mind that **these are not recommendations of the National Council of Welfare, but rather our guess as to some of the changes the Minister of Finance may be contemplating**):

a. do nothing

Partial indexation of income taxes, child benefits and federal transfers to the provinces will enhance the government's financial position by billions of dollars with each passing year. Massive as they are, however, these savings are invisible - as they involve taxes that would not have been collected and benefits that would have been spent - and so do not appear on the government's public ledgers. They are not enough to appease the deficit-cutters.

b. restrict indexation even more

By increasing the partial indexation formula from the current three percent to, say, four percent a year, the finance minister would save many millions more in child benefit payments and collect millions more in income tax each year. With inflation beginning to inch up over four percent, this would be a handy cost-saving move.

The Minister of Finance could do the same thing to the indexation formula for federal transfers to the provinces under EPF for health and postsecondary education. In 1986 he restricted the annual increase to the rise in the GNP minus two percentage points. He could simply raise this figure to three percentage points or more, thereby savings millions in federal spending.

These changes would be felt by most Canadians one way or another. Parents would see even larger cuts in their child benefits. Taxpayers would pay more taxes; those with below-average incomes would suffer most.

Cutting federal transfers for health services and postsecondary education would put an extra financial squeeze on the provincial governments, which already complain about rising costs and decreasing federal financial assistance. The provinces, in turn, could in effect pass along these costs to the consumer in the form of cuts or delays in health services and reductions in funding to universities and community colleges (which, in turn, might cut back their services and/or raise tuition fees). Higher provincial sales and income taxes probably would follow as well.

c. double-index child and elderly benefits

A variant on the partial indexation theme would be to use the same technique that was applied as part of the '6 and 5' anti-inflation program in 1983-84. Old Age Security benefits could be partially indexed but the Guaranteed Income Supplement indexed by an extra amount in order to ensure that low-income pensioners not suffer a reduction in their total benefits from the two programs. Even minor tinkering with the indexing formula for such a costly program as Old Age Security would yield substantial savings.

The same method could be applied to child benefits. The partial indexation formula for family allowances could be tightened but the refundable child tax credit indexed at a higher rate. However, the option mentioned above - reducing the inflation protection of all child benefits - would save the government more money, though low and middle-income families would suffer more.

d. hike taxes further

Since the powerful new national sales tax is a couple of years down the road, the government likely will continue its past practice and keep ratchetting up federal sales and excise taxes.

The Minister of Finance has said he will remove the surtax which applies to all taxpayers and corporations only after the new sales tax is in place. In the meantime, he could increase this surtax above its current rate of three percent of basic federal tax. Alternatively, he could re-impose the surtax on upper-income taxpayers that lasted from July 1985 to December 1986, perhaps calling it a 'social development' tax in order to emphasize the cost of social programs, or an 'anti-deficit' tax.

Some groups have urged the government to make corporations pay a larger share of tax - e.g., by eliminating tax concessions, raising tax rates or imposing a minimum tax on profitable corporations that pay little or no tax. While the finance minister may make further cuts to corporate tax breaks (which he already trimmed a fair amount in his last term), he risks incurring the wrath of business leaders who say government should cut back on concessions to the private sector but who oppose those cuts which hurt their own specific industry.

Making corporations pay more taxes could end up **increasing** the tax burden on individual Canadians. If, as is suspected, business passes along its tax increases to consumers in the form of higher prices and employees in the form of lower wage settlements, then consumers and workers will pay the price of corporate tax hikes.

e. slaughter the sacred cow of universality

Some business lobby groups, economists and editorialists believe it is high time the government stopped paying benefits to people who don't need them. They contend that cutting off the non-deserving from old age pensions and family allowances - and maybe unemployment insurance and the Canada and Quebec Pension Plans, while we're at it - would save billions of dollars that could be used to pay down the deficit.

While some Canadians might find this view sensible, in fact the anti-universalists display an astonishing ignorance of social programs and the political realities facing federal governments in this country.

The **Old Age Security** program could yield substantial savings if the better-off elderly were disqualified from benefits because it is the most costly social program in Canada. However, the only way to wring massive, deficit-crunching savings from the old age

pension would be to set the cutoff point at middle-income levels - in politically dangerous territory.

The large majority of pensioners have very modest incomes, so the amount of money that could be saved by denying benefits to affluent seniors would be in the millions, not billions, and perhaps not worth the political risks involved. Canadians 65 and older are concentrated on the lower rungs of the income ladder: Of the 2.3 million elderly households (i.e., families and single persons) in 1988, more than half (1.2 million or 52.2 percent) had incomes below $10,000; close to two-thirds (1.5 million or 64.8 percent) were under the $15,000 mark; only one in ten (230,000 or 10.2 percent) had incomes above $40,000; and a scant 65,000 or 2.8 percent figured in the $70,000 or more group. Figure M shows that most Old Age Security benefits go to pensioners with incomes under $20,000 - $7.5 billion out of the $10.6 billion total.

If the federal government decided to deny the old age pension to elderly households with incomes above $70,000 it would pay out $350 million less. However, Old Age Security payments are counted as taxable income; the federal and provincial treasuries recovered through the tax system about $1.8 billion of the total $10.6 billion in payments in 1988. Factoring in the $140 million in combined federal and provincial income taxes that the over-$70,000 elderly now pay on their old age pensions, then the net savings to the federal government from restricting benefits to those with income under $70,000 would be only $280 million.

Of course, the finance minister could save a lot more if he lowered the cutoff point for the old age pension. If he set the limit at $50,000, he would cut 150,000 households from the Old Age Security rolls and save his government about $638 million. Lowering the cutoff to $40,000 would exclude 230,000 aged families and singles and save the federal treasury $1.0 billion. If he went as low as $25,000, he would exclude 465,000 elderly households at a savings of approximately $2.0 billion. Now we are talking big money.

The finance minister must weigh the political risks of cutting a universal program like the old age pension which serves a large and increasingly powerful constituency. **The dilemma facing any federal government in Canada is that fiscal and political arithmetic work quite differently.** The lower the government set the income cutoff for Old Age Security, the more money it would save but the more votes it could lose. Setting the cutoff higher up the income ladder would yield smaller savings and perhaps not prove so politically inflammatory, but raises the question as to whether the fiscal gain outweighs the political pain.

The old age pension is the bedrock of our retirement income system. It is a popular, well-known benefit that serves more

Canadians than any other social program. Any move to 'de-universalize' Old Age Security would have to be implemented slowly and carefully so as not to panic seniors who fear a loss in benefits (even if they are actually below the cutoff point) and those above the cutoff point who had counted on receiving the benefit as a part (albeit small) of their retirement income.

Given the widespread protest that greeted the finance minister's 1985 proposal to partially index the old age pension - a tiny change compared to de-universalizing the program - it seems unlikely that he will attempt such radical surgery in his upcoming budget.

Unlike the old age pension, **family allowances** are fairly evenly distributed throughout the income spectrum because families with children are not concentrated at the bottom of the income ladder. However, like Old Age Security benefits, family allowances are taxed, which means that higher-income families pay back a substantial portion of their family allowances to the federal and provincial governments. Taxfilers in the top tax bracket - those with net incomes over $55,000 a year - pay back about 45 cents for every dollar of family allowance benefits. (See Figures O and P).

Since there is a much larger proportion of children than of elderly persons living in upper-income families, denying family allowances to better-off parents might seem a financially more attractive proposition to the federal government. It might be less perilous politically as well, since recent experience would suggest that the government can get away with cuts to child benefits but not to elderly benefits (we are referring to the controversy surrounding partial indexation, which the finance minister successfully applied to child benefits but failed to implement for the old age pension).

However, the family allowance is not as ripe a plum as its critics believe because it is a much smaller program than the old age pension - indeed, the smallest of the federal statutory social programs. Family allowances will pay out $2.6 billion this fiscal year compared to $11.9 billion for Old Age Security. Moreover, one-third of family allowance payments are returned to the federal and provincial treasuries at income tax time compared to only one-sixth of old age pensions.

Cutting off affluent families with incomes over $70,000 from the family allowance program would exclude 430,000 families and yield only $215 million in federal savings. However, if the federal government decided to deny family allowances to the 1.1 million families with incomes over $50,000 (about average income for a family with two children), it would save in the order of $635 million. While this is nothing to sneeze at, it would entail some political risk - women's and social policy groups would howl, as

would some of the one million families that would be cut off the program - though probably not as much as any attempt to de-universalize the old age pension.

Dropping the cutoff point for family allowances lower would enrich the federal treasury a lot more. If the income cutoff were set at $40,000, 1.8 million families would lose their baby bonus at a net savings of $1.0 billion in federal funds. However, this drastic change would deny benefits to families with incomes as low as $10,000 below the average for a family with two children.

It is hard to take seriously those cost-cutters who argue that the two federal social insurance programs - **unemployment insurance and the Canada Pension Plan** - should not pay benefits to unemployed and retired persons above a certain income level. Canadians contribute directly to these programs when they are employed in order to replace income lost when they are out of work or retired. The fact that upper-income beneficiaries had more income when they were employed is irrelevant.

Can you imagine paying car insurance premiums and then being denied benefits when you have an accident because your income is too high? If the federal government did decide to restrict unemployment insurance and the Canada Pension Plan to persons below a certain income level, it could hardly require those who cannot qualify for benefits to continue paying premiums. But the power of social insurance lies in its pooling of public resources in order to protect against loss of income experienced by large segments of the population at some point in their lives: restricting benefits and contributions to a smaller group of Canadians would weaken this crucial element of our income security system.

f. the 'clawback'

The government could avoid the political risks inherent in de-universalizing old age pensions and family allowances by taxing more benefits back from their recipients. This technique is sometimes called a 'clawback' or 'taxback'.

Few Canadians realize that the federal government already uses a clawback in the unemployment insurance program. All unemployment insurance recipients with taxable income must pay income tax on their benefits. Those with net income over $44,070 in 1988 who received unemployment insurance also have to pay back up to 30 percent of their UI benefits for that year; this is a clawback.

The same technique could be applied to Old Age Security and family allowances. The government could impose a clawback on pensioners and parents with incomes above a certain level.

Two features of the clawback would determine its revenue-generating power. The lower the income level at which the clawback kicked in, the more money the government would recoup at tax time. The higher the rate of the clawback, the greater the savings.

For the sake of argument, suppose the federal government decided to tax back one-third of Old Age Security benefits and family allowances paid to recipients with incomes over $50,000. This clawback would yield net savings of $117 million from the old age pension and $101 from family allowances, for a total of $218 million. If the same ($50,000) income threshold were kept but the taxback rate raised to 50 percent, federal savings would be considerably higher - $248 million from Old Age Security and $235 million in family allowances, for a total of $483 million.

The advantage of the clawback is that it saves money not by tampering with the contentious principle of universality, but rather by increasing the progressivity of social programs. Most defenders of universality believe that benefits should be distributed in a progressive fashion - i.e., the higher your income, the less you should receive, and vice versa. The clawback does no damage to universality - old age pension and family allowances cheques still would go out to all pensioners and parents, regardless of their income - but it does reduce the net value of benefits to upper-income recipients.

In effect, the clawback would offset the 1982 and 1988 reductions in the top marginal tax rate which lowered the taxback of benefits through the income tax system and so raised the net value of family allowances and old age pensions paid to affluent recipients. The government could argue that imposing a clawback would serve two desirable goals - save money and distribute benefits according to need.

g. take the axe to unemployment insurance

There are other ways to cut billions of dollars from unemployment insurance than restricting the program to persons below a certain income level. But they likely would not prove any more feasible.

The federal government pays $2.7 billion or one-quarter of the $10 billion price tag for unemployment insurance; the other three-quarters is covered by employer and employee premiums. Most of the federal share covers the cost of 'regionally extended benefits'. This feature provides UI recipients two additional weeks of benefits for every half percentage point in the jobless rate in areas where unemployment exceeds four percent, up to a maximum of 32 weeks.

The government could tighten up on this aspect of the UI program or even discard it altogether, perhaps requiring employers and employees to take over the federal share. However, any cuts to regionally extended benefits would hurt high-unemployment regions of the country such as Atlantic Canada, whose Members of Parliament would come under the gun. The provinces would complain that such a move would swell their welfare rolls. Ottawa probably would have to compensate those affected with alternative measures such as job creation, training and literacy and educational upgrading programs that, in turn, would have to be paid for. In the end, the federal treasury would be little better off, unless it spent considerably less on the employment alternatives than it does now on unemployment insurance.

The same dilemma holds for other cost-cutting moves that have been proposed by business groups wanting to reduce the cost of employer premiums and increase their supply of (cheap) labour, such as tightening up on UI entrance requirements and reducing the amount of benefits paid. While these changes do not directly affect federal spending, indirectly they could to the extent that demands to compensate UI recipients hurt by these changes would put pressure on the federal government to finance itself or cost-share with the provinces alternative employment programs.

Major changes to unemployment insurance are going to be made, but probably more with a view to reallocating resources from income maintenance to employment programs than slashing spending. Some savings to the federal treasury may result, but in the end they are unlikely to be massive since what the federal government saves on unemployment insurance it likely will have to spend (at least in part) on alternative measures.

Conclusion: Is There a Fair Way to Fight the Deficit?

The particular tax increases and social spending cuts that the government imposed during its first term in office have not been fair. They have hit the working poor and middle-income families harder than the well-off. Many upper-income Canadians are enjoying substantial tax cuts thanks to recent changes in the income tax system.

The various anti-deficit options considered in the previous section would vary in their impact. Tougher partial indexation of child benefits and income taxes would squeeze low and middle-income Canadians even harder. A clawback on old age pensions and family allowances would affect upper-income seniors and families; if the government decided to save more money by applying the clawback to middle-income recipients, then a lot more Canadians would experience reductions in their social benefits. A high-income surtax would hit only upper-income taxpayers; an increase in the existing general surtax would affect middle and lower-

income taxpayers as well. Cuts in federal transfers to the provinces for health and postsecondary education would have a very wide impact that would be felt by patients, students and taxpayers.

Many people would probably agree that upper-income citizens should swallow a stronger dose of anti-deficit medicine than the middle class, and that lower-income families and individuals should be spared altogether. If so, then what kind of measures should the finance minister adopt in his 1989 budget?

There is a strong possibility that the government will introduce a clawback on family allowances and, perhaps, old age pensions. That seems a more likely and politically prudent option than 'de-universalizing' these popular social programs. But this is not the best way of getting more money from affluent Canadians, either in terms of dollars or equity.

Why should parents with above-average incomes have more of their child benefits taxed back from them, yet childless couples and single persons in the same income range be left unscathed? Why should affluent pensioners carry more of the burden of deficit-reduction than well-off persons under age 65? Figures O through R show that upper-income parents and pensioners already pay back a sizable portion of their benefits at income tax time.

Canada's oldest child benefit, the children's tax exemption, was introduced in 1918 in recognition of the heavier financial burden borne by parents compared to childless taxpayers with the same incomes. (This is sometimes referred to as the principle of 'horizontal equity'). In 1988, the children's tax exemption was replaced by a non-refundable credit that is worth less to upper-income families. Denying or reducing family allowances to upper-income families would weaken further the principle of horizontal equity and the long-standing Canadian tradition that the child-rearing contribution of parents at all income levels deserves some recognition by the state.

There is a fairer alternative - a fairer tax system that protects the poor and collects more tax from the well-off.

Recent and impending income tax changes which favour affluent taxpayers will result in billions of dollars in lost tax revenue that could be used to fight the deficit. Prominent among these costly and regressive measures are the introduction of the $100,000 lifetime capital gains exemption, a tripling of tax deduction limits for contributions to RRSPs, and lowering the top marginal tax rate from 34 to 29 percent.

Abolishing the $100,000 capital gains exemption, fully taxing capital gains, converting the RRSP deduction to a credit and raising the top marginal tax rate (e.g., from 29 to 32 percent)

would be a fairer way of fighting the deficit than hitting working poor and middle-income Canadians with additional tax increases and cutting social benefits. These four changes alone would save the federal government in the order of $2 billion a year.

TABLE 1

FEDERAL EXPENDITURES AND REVENUES, CONSTANT (1989) DOLLARS, 1984/85 - 1989/90

($ millions)

Expenditures	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Statutory Programs						
Unemployment Insurance	12,292	11,778	11,797	10,984	10,639	10,610
Old Age Pensions	13,962	14,726	15,187	15,653	16,151	16,540
Family Allowances	2,957	2,940	2,862	2,776	2,688	2,605
Canada Assistance Plan	4,579	4,604	4,576	4,664	4,649	4,630
Established Programs Financing	10,510	10,202	9,984	9,658	9,792	9,845
Subtotal (social spending)	44,301	44,251	44,406	43,735	43,919	44,230
Fiscal Transfers	7,939	7,672	7,859	7,943	8,138	8,200
Other	6,479	6,739	6,697	8,608	8,512	7,345
Total	58,718	58,662	58,962	60,286	60,575	59,775
Non-Statutory Programs						
Defence	10,714	10,692	11,302	11,298	11,534	11,795
Official Development Assistance	2,554	2,133	2,549	2,754	2,808	2,780
Other	34,106	29,383	28,540	29,634	29,286	27,515
Total	47,375	42,207	42,392	43,686	43,628	42,090
Program Spending	106,093	100,869	101,354	103,972	104,203	101,865
Public Debt Charges	27,459	29,912	30,111	31,620	33,337	33,035
Total Budgetary Expenditures	133,551	130,780	131,466	135,592	137,540	134,900
Revenues						
Personal Income Tax	35,773	38,808	42,785	47,722	47,226	47,590
Corporate Income Tax	11,469	10,828	11,166	12,336	12,480	13,500
Sales and Excise Taxes	17,244	19,885	23,735	23,894	27,929	26,810
Unemployment Insurance	9,236	10,243	10,796	11,298	11,024	10,235
Other	12,966	10,558	8,414	8,690	8,778	8,175
Total Revenues	86,688	90,323	96,896	103,940	107,437	106,310
Deficit	46,864	40,458	34,570	31,653	30,103	28,590

TABLE 2

FEDERAL SAVINGS FROM PARTIAL INDEXATION OF FAMILY ALLOWANCES, ESTABLISHED PROGRAMS FINANCING AND PERSONAL INCOME TAX, CONSTANT (1989) DOLLARS, 1986-1991

($ millions)

	Family Allowances	Established Programs Financing	Personal Income Tax System	Total
1986	$ 86	357	888	1,331
1987	171	735	1,776	2,682
1988	251	1,132	2,564	3,947
1989	329	1,545	3,356	5,230
1990	385	1,987	4,159	6,531
1991	464	2,427	4,970	7,861
TOTAL	1,686	8,183	17,713	27,582

TABLE 3

TOTAL (FEDERAL AND PROVINCIAL) INCOME TAXES, TWO-EARNER COUPLES WITH TWO CHILDREN, CONSTANT (1989) DOLLARS, 1984-1991

	Working Poor	Middle Income	Upper Income
1984	$1,280	$7,846	$34,374
1988	1,844	8,643	32,333
1991	2,050	9,212	32,168
Percentage Change			
1984/88	44.1%	10.2%	-5.9%
1984/91	60.2	17.4	-6.4

Note: Taxes include refundable child tax credit.
One child is under age 6, one child over 6.
Working poor family earns $24,000; middle-income family, $49,000; upper-income family, $122,000.

TABLE 4

FEDERAL CHILD BENEFITS, COUPLES WITH TWO CHILDREN, CONSTANT (1989) DOLLARS, 1984-1991

	Welfare Poor	Working Poor	Middle Income	Upper Income
1984	$1,718	$1,979	$1,962	$2,226
1988	1,929	1,922	1,578	2,357
1991	1,967	1,891	1,455	2,100
Percentage Change				
1984/88	12.3%	-2.9%	-19.6%	5.9%
1984/91	14.5	-4.4	-25.8	-5.6

Note: Family earnings are: welfare poor, $0; working poor, $24,000; middle-income, $49,000; upper-income, $122,000.

Child benefits, which vary by family type and income, include family allowances, refundable and non-refundable child tax credits and child care expense deduction.

Figure A

FEDERAL DEFICIT
1984/85-1989/90

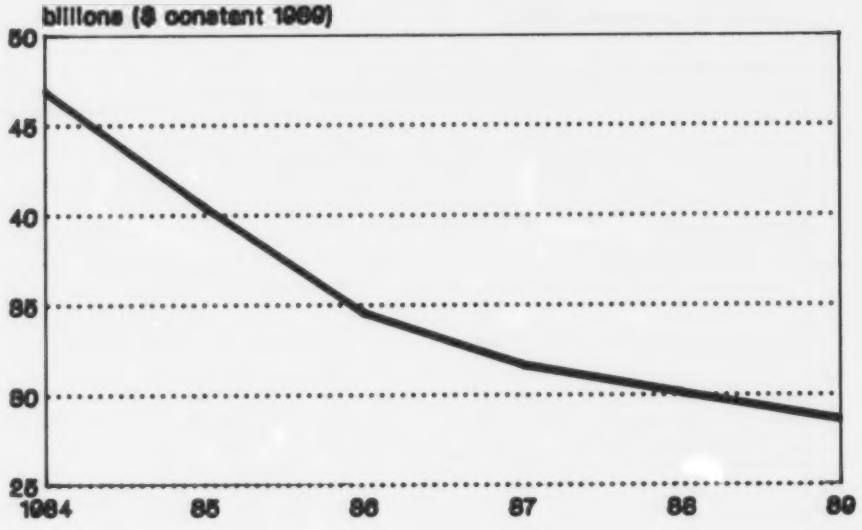


Figure B

FEDERAL DEFICIT AS PERCENTAGE OF
GROSS DOMESTIC PRODUCT, 1984/85-1989/90

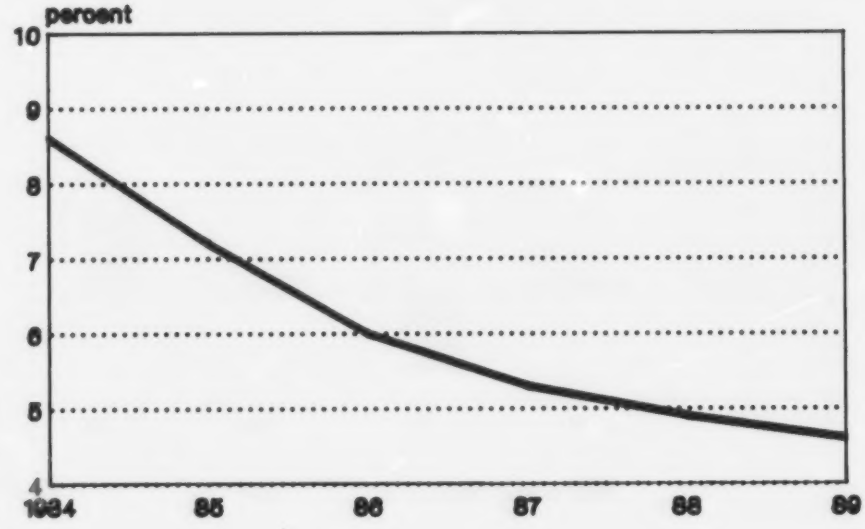


Figure C

FEDERAL SOCIAL SPENDING
1984/85-1989/90

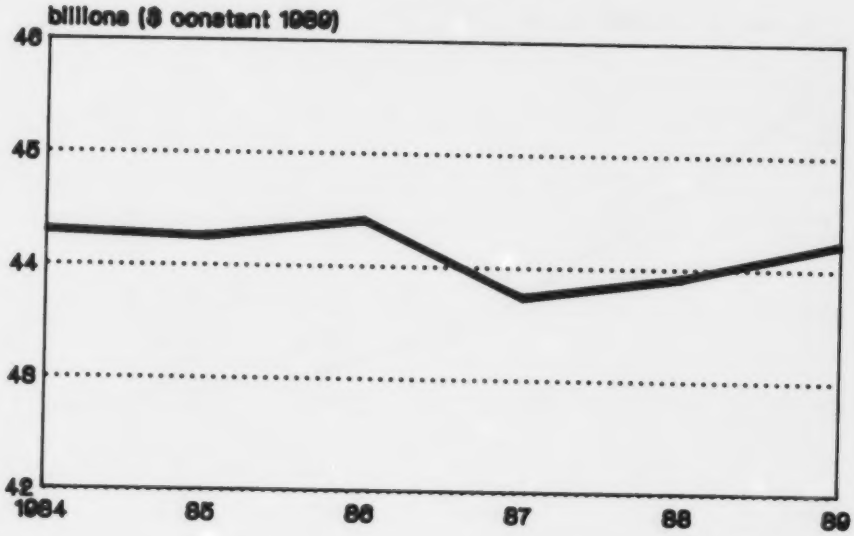


Figure D

ANNUAL CHANGES IN SOCIAL SPENDING AND
GROSS DOMESTIC PRODUCT, 1985/86-1989/90

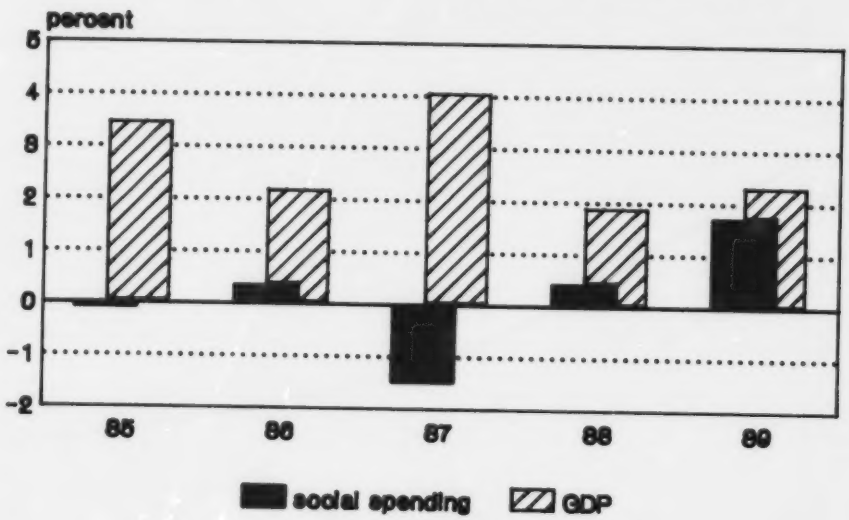


Figure E

FEDERAL STATUTORY SOCIAL SPENDING,
BY PROGRAM, 1984/85-1989/90

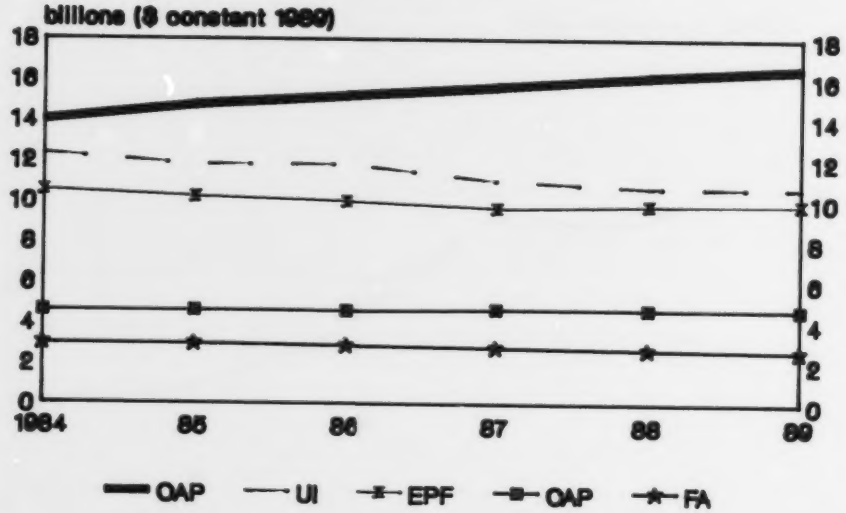


Figure F

OLD AGE PENSIONS SPENDING
1984/85-1989/90

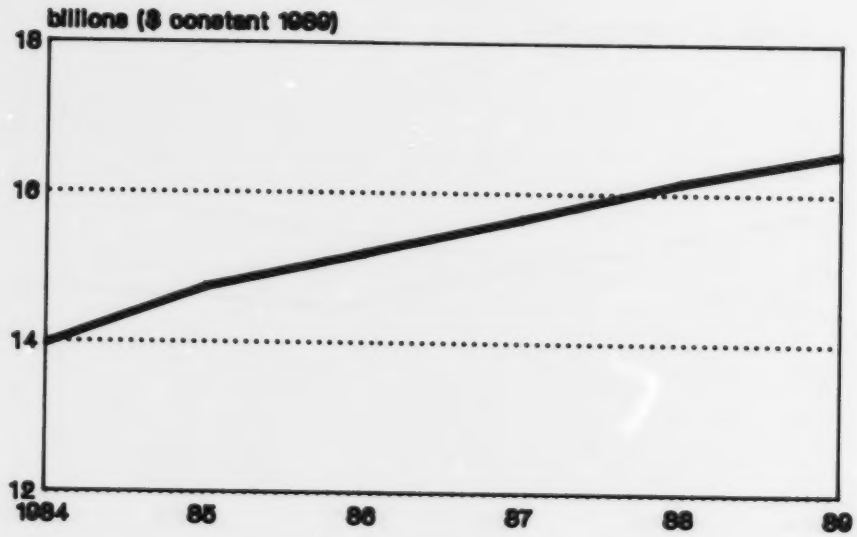


Figure G

UNEMPLOYMENT INSURANCE SPENDING
1984/85-1989/90

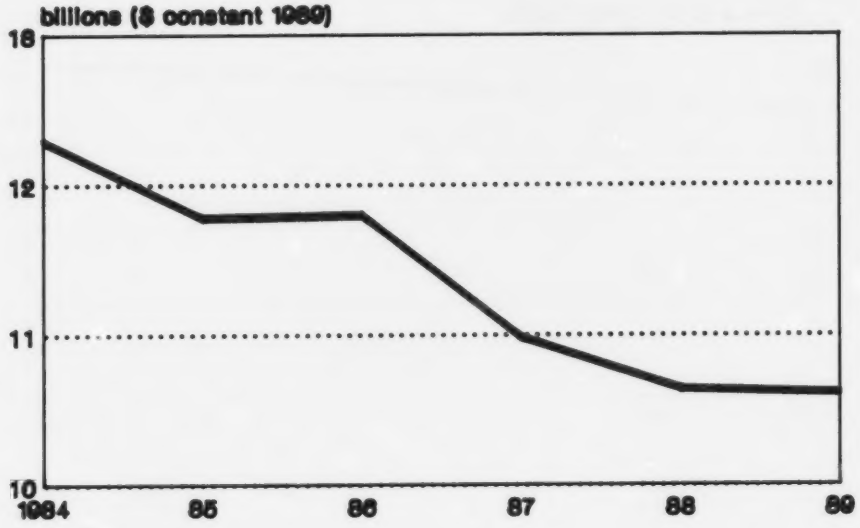


Figure H

ESTABLISHED PROGRAMS FINANCING
SPENDING, 1984/85-1989/90

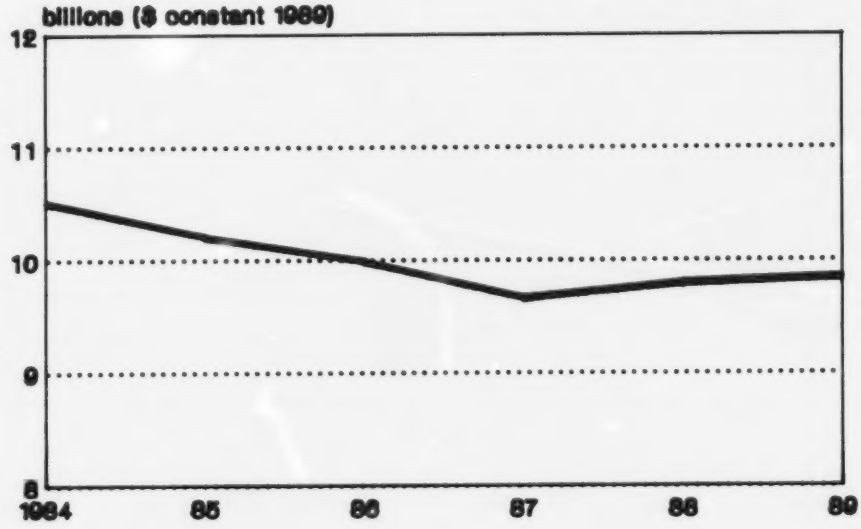


Figure I

CANADA ASSISTANCE PLAN
SPENDING, 1984/85–1989/90

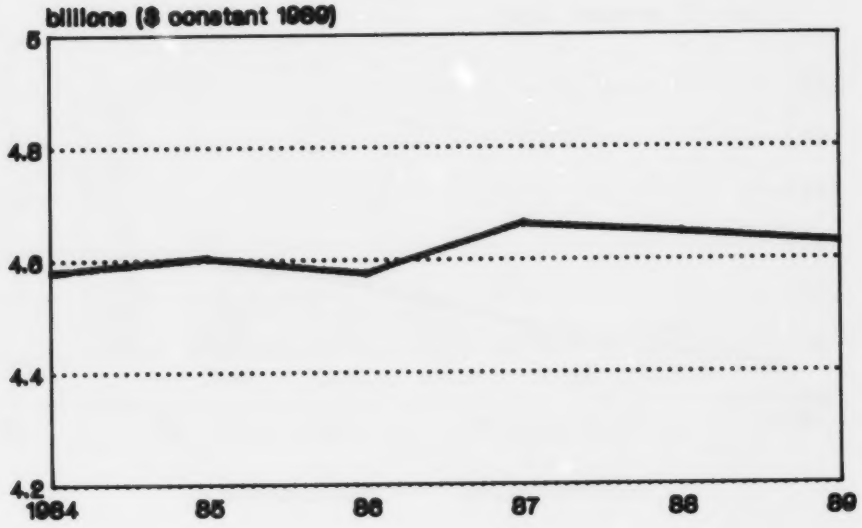


Figure J

FAMILY ALLOWANCE SPENDING
1984/85–1989/90

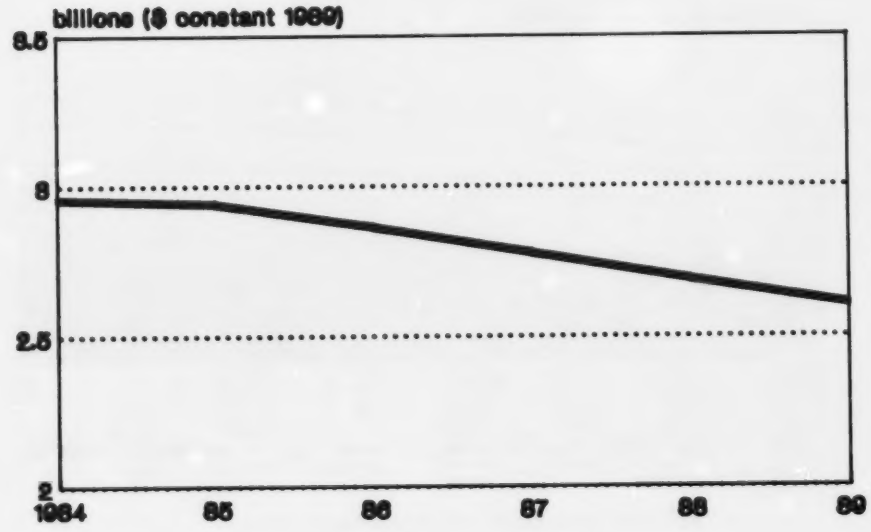


Figure K

FEDERAL REVENUES AND EXPENDITURES
1984/85-1989/90

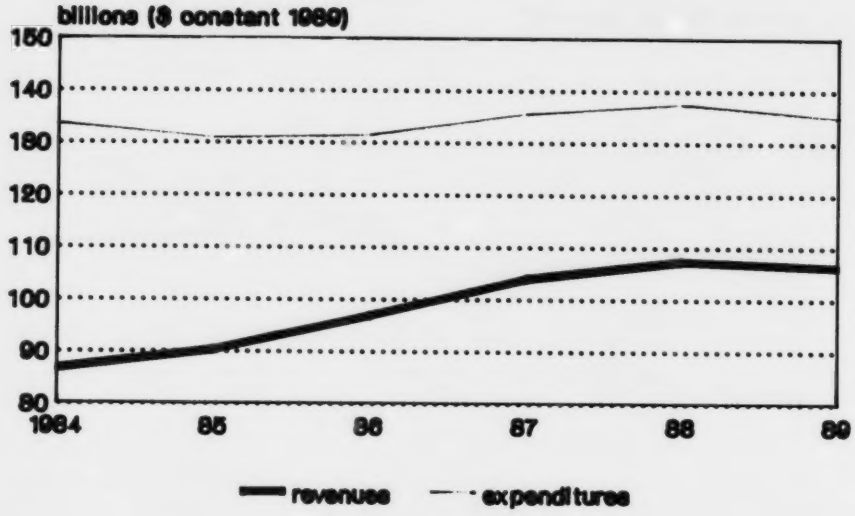


Figure L

FEDERAL TAX REVENUES, BY SOURCE,
1984/85-1989/90

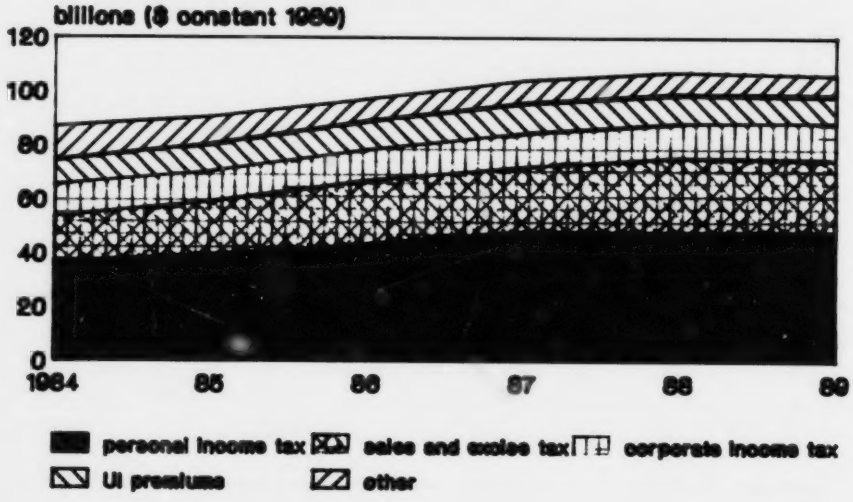


Figure M

OLD AGE SECURITY, BEFORE AND AFTER INCOME TAXES, BY FAMILY INCOME, 1988

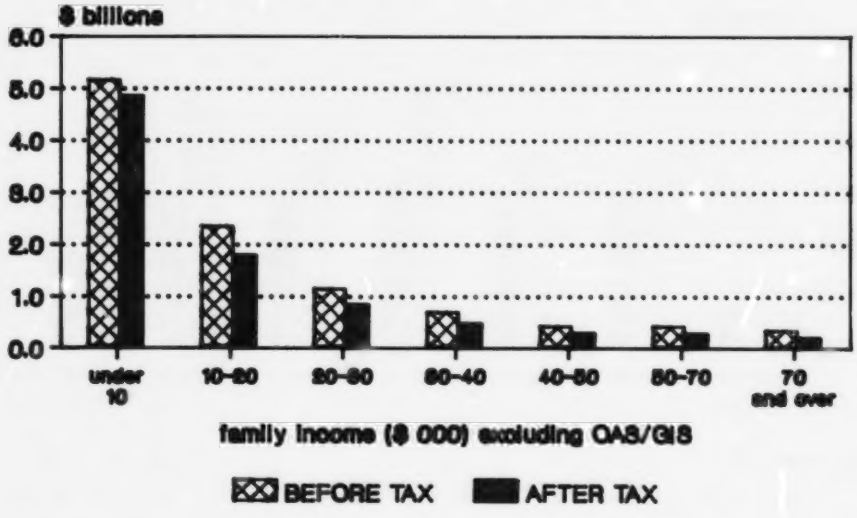


Figure N

PERCENTAGE OF OLD AGE SECURITY PAID BACK IN INCOME TAXES, BY FAMILY INCOME, 1988

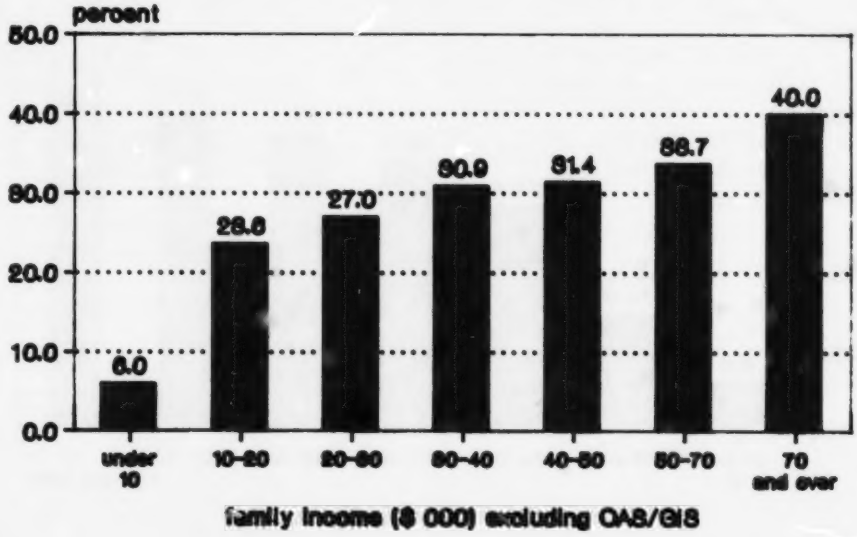


Figure O

FAMILY ALLOWANCES, BEFORE AND AFTER INCOME TAXES, BY FAMILY INCOME, 1988

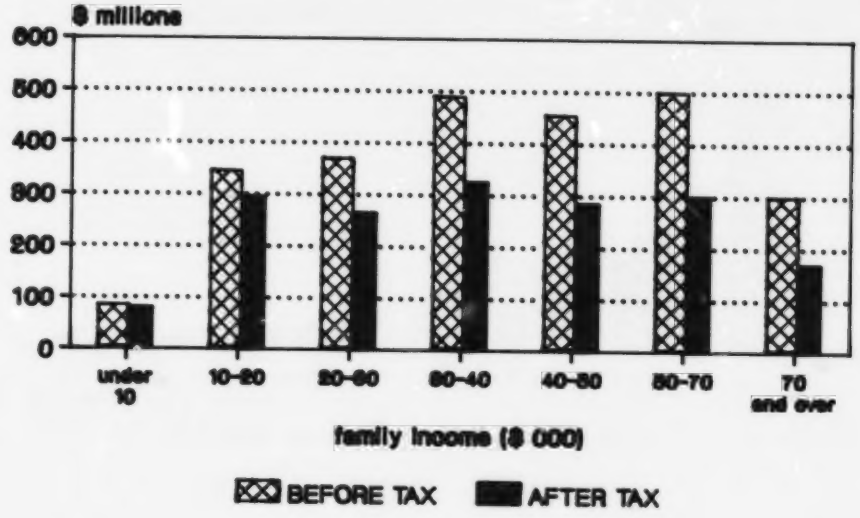
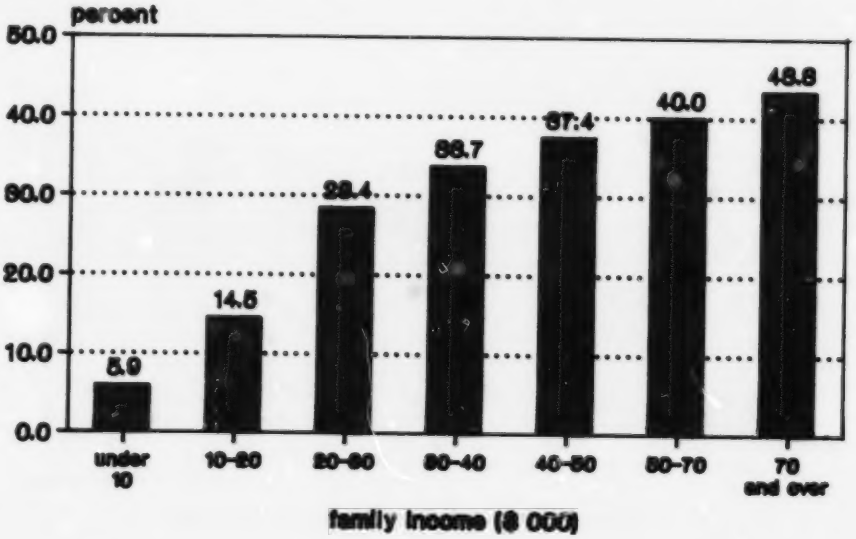


Figure P

PERCENTAGE OF FAMILY ALLOWANCES PAID IN INCOME TAXES, BY FAMILY INCOME, 1988



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National Council of Welfare
Brooke Claxton Building
Ottawa K1A 0K9

Director: Ken Battle
Assistant Director: Steve Kerstetter
Translation: Louise Ducharme

NATIONAL COUNCIL OF WELFARE

The National Council of Welfare was established by the Government Organization Act, 1969 as a citizens' advisory body to the Minister of National Health and Welfare. Its mandate is to advise the Minister on matters pertaining to welfare.

The Council consists of 21 members, drawn from across Canada and appointed by the Governor-in-Council. All are private citizens and serve in their personal capacities rather than as representatives of organizations or agencies. The membership of the Council has included past and present welfare recipients, public housing tenants and other low-income citizens, as well as lawyers, professors, social workers and others involved in voluntary service associations, private welfare agencies, and social work education.

Reports by the National Council of Welfare deal with a wide range of issues on poverty and social policy in Canada, including: income security programs, medicare, poverty lines and poverty statistics, the retirement income system, the aged, tax reform, the working poor, children in poverty, community economic development, women and poverty, employment policy, single-parent families, social services, nutrition, community organizing, child welfare, poor people's groups, legal aid/legal services, low-income consumers, poverty coverage in the press and welfare reform.

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